Supreme Court, U.S.
FILED
JAN 5 1981
R. CLERK

NO. 79-1423

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal,
Second Appellate District, State of California

REPLY BRIEF FOR THE APPELLANT

Alan R. Vogeler
(Counsel of Record)
2500 Central Trust Center
201 East Fifth Street
Cincinnati, Ohio 45202
(513) 651-6800

Attorney for Appellant, The Western and Southern Life Insurance Company

OF COUNSEL:

Barbara G. Watts
Frost & Jacobs
2500 Central Trust Tower
201 E. Fifth Street
Cincinnati, OH 45202

COURT INDEX PRESS, INC. — 215 E. Ninth Street, Cincinnati, Ohio 45202 — (513) 241-1450

TABLE OF CONTENTS

	Page
Introduction	1
The Effect of Western and Southern's California License	2
The Effect of the McCarran-Ferguson Act	5
Retaliatory Taxes Do Not Secure Comity, Uniformity Nor Even-Handed Treatment	7
Conclusion	11
Addendum	1a-2a-3a

TABLE OF AUTHORITIES

CASES

Atlantic Insurance Co. v. *State Board of Equalization,* 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1st Dist. 1967)	3
Dow v. *Lallie,* 26 N.D. 512, 144 N.W. 1082, 1088 (1914)	7
In Re Insurance Tax Cases, 160 Kan. 311, 161 P. 2d 734 (1945)	5
Hanover Fire Insurance Co. v. *Harding,* 272 U.S. 494 (1926)	3, 4, 6
Lincoln Life Insurance Co. v. *Read,* 325 U.S. 673 (1945)	4
Prudential Insurance Company v. *Benjamin,* 328 U.S. 408 (1946)	5
Prudential Insurance Company v. *Hobbs,* 328 U.S. 822 (1946)	5

Page

Southern Railway Co. v. *Greene,* 216 U.S. 400 (1910) 3, 6

State Board of Insurance v. *Todd Shipyards,* 370 U.S. 451 (1962) 6

Western and Southern Life Insurance Company v. *State Board of Equalization,* 4 Cal. App. 3d 21, 84 Cal. Rptr. 88 (1970) 2

WHYY v. *Glassboro,* 393 U.S. 117 (1968) 6

STATUTES

California Insurance Code, Sec. 701 3

California Revenue and Taxation Code, Sec. 12241 (b) 9

McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015 ..... 4, 5, 6

CONSTITUTIONAL PROVISIONS

California Constitution

Article XIII, 14-4/5 (e) 2, 1a
Article XIII, 14-4/5 (f) (3) 2, 2a

United States Constitution

Article I, Sec. 8, Clause 3 6
Article XIV, Sec. 1 6

NO. 79-1423

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal, Second Appellate District, State of California

REPLY BRIEF FOR THE APPELLANT

INTRODUCTION

Appellant, the Western and Southern Life Insurance Company ("Western and Southern") hereby submits its Reply to the Brief of the Appellee, State Board of Equalization of the State of California (the "Board") and to the briefs *amici curiae* filed in support of the Board's position.[1]

[1] *Amicus* briefs include the Brief *Amicus Curiae* of American Insurance Association, National Association of Independent Insurers, The

Western and Southern acknowledges that the Board's brief correctly points out typographical errors in the printing of California Constitution Article XIII Section 14-4/5, sub-paragraphs (e) and (f) (3) in the Statutory Appendix of the "Brief for the Appellant;" those sections are correctly reproduced in the addendum hereto, beginning on page 1a.

I. THE EFFECT OF WESTERN AND SOUTHERN'S CALIFORNIA LICENSE.

The first issue addressed by the Board is whether California may impose discriminatory conditions upon Western and Southern after its receipt of its license for an indefinite term. (Board brief, p. 8-10)

Alliance of American Insurers and State Farm Mutual Automobile Insurance Company (the Property Insurers' brief); the *Amicus* Brief of the State of Tennessee (Tennessee brief); the Brief for States of Arizona and Wisconsin as *Amici Curiae* (Arizona, Wisconsin brief), and the Brief *Amicus Curiae* of the American Council of Life Insurance (ACLI brief). Since Appellant has been advised by the Clerk that this Court will not determine until after the submission of this Reply whether it will permit the ACLI brief to be filed, pertinent portions of that brief are addressed herein. In the Property Insurers brief, counsel erroneously suggests to this Court (Statement, p. 2-3) that it has been misled concerning the non-discriminatory character of Ohio laws taxing foreign insurance companies and attempts to prove such contention by citing Ohio law and depositing with the clerk what he calls "copies of Appellant's recent returns." Aside from the impropriety of trying to prove facts in this Court unsupported by the record and the irrelevance of discrimination by Ohio under the California retaliatory tax provisions at issue in this case, the California courts have twice found that Ohio does not discriminate in general against foreign insurers (*Western and Southern* v. *State Board of Equalization*, 4 Cal. App. 3d 21, 84 Cal. Rptr. 88 (1970); *Western and Southern* v. *State Board of Equalization*, Superior Court, Los Angeles County, #C3189, Conclusions of Law, Joint Appendix, p. 75). Moreover, the materials lodged with the clerk pursuant to footnote 1 of the Property Insurers' brief are work papers of an Ohio Department employee, not Western and Southern tax returns.

The stipulated facts are that Western and Southern was issued a license to do business in California in 1956 for an indefinite term. It did not have to apply for a new license every year, although the license required the company to continue to comply with California law.

It is clear that out-of-state insurers which have established businesses in a state under an indefinite or unequivocal license are entitled to the protection of the equal protection clause against discriminatory taxation (See Brief *Amicus Curiae* of Life Insurance Council of New York ("LICONY BRIEF") at p. 6-7). As the California Court of Appeal in *Atlantic Insurance Co.* v. *State Board of Equalization,* 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1st Dist. 1967) said:

> . . . California, unlike most states, grants certificates of authority to transact insurance business for an indefinite period subject to payment of a $10 annual fee. . . . A certificate is not granted until the applicant conforms to requirements of California law prerequisite to its issue. After such issue the insurer must continue to comply with requirements of law. . . .
>
> Unlike insurers who must obtain an annual license to conduct business, appellants appear to have obtained "unequivocal" licenses to do business. The fact that the California certificates of authority could be revoked for failure to pay taxes or to otherwise comply with the law (Ins. Code, Section 701) does not alter that position. (*Hanover Fire Ins. Co.* v. *Harding, supra,* 272 U.S. 494, is said to stand for the proposition that once a foreign corporation has been unconditionally admitted to do business in a state it must be granted equal protection. (272 U.S. at p. 514.) (255 Cal. App. 2d at 13-14, 62 Cal. Reptr. at 792).

The Board has abandoned its original argument (Reply to *Amicus Curiae* Brief of the United States, filed September 25, 1980, p. 4-5) that Western and Southern's license

was "conditional" (*i.e.*, not unequivocal) and hence within the ambit of *Lincoln Life Insurance Co.* v. *Read,* 325 U.S. 673 (1945), which held equal protection inapplicable in the case of a conditional license. This Court could justifiably remove any distinction between "conditional" and "unequivocal" licenses and hold that the same constitutional protections are available to both kinds of licenses. If it chooses not to do so, however, it is clear that Western and Southern's indefinite license falls with the scope of *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926), and thus within the exception recognized in *Lincoln* and that Western and Southern is entitled to equal protection. As this Court stated in *Lincoln* in carving out cases where equal protection applies:

> We can put to one side such cases as *Hanover F. Ins. Co.* v. *Harding* . . ., where-a-foreign insurance company, having obtained an unequivocal license to do business in Illinois and built up a business there, was subsequently subjected to discriminatory taxation. . . . appellant, unlike the foreign corporation in *Hanover F. Ins. Co.* v. *Harding,* never obtained from Oklahoma an unequivocal license to do business there; it agreed to pay not only for the renewal but also for the retention of its annual license such taxes as Oklahoma might impose. (*Supra,* p. 676)

Since Western and Southern had been admitted into California on an indefinite license, it was entitled to all the protections of the Constitution, including guarantees against interference with interstate commerce to the extent not authorized by the McCarran-Ferguson Act. Furthermore, as the Board now acknowledges (Board brief, p. 9), Western and Southern cannot be required to submit to a violation of its due process and equal protection rights. Whether the retaliatory tax is such a violation will be determined by this Court.

II. THE EFFECT OF THE McCARRAN-FERGUSON ACT.

The Board urges that the McCarran-Ferguson Act as construed by this Court gives California blanket authority to impose any retaliatory tax it may wish without regard to the commerce clause (Board brief, p. 11-20). In reaching this conclusion the Board would give this Court's opinion in *Prudential* v. *Benjamin,* 328 U.S. 408 (1946), the broadest possible construction, arguing that the McCarran Act freed all state taxation, discriminatory or not, (and regardless of impact) from commerce clause restraints. This Court, however, carefully circumscribed the scope of its decision in *Prudential* v. *Benjamin* and stressed that it was expressing no opinion concerning the validity of any of the myriad of state taxing statutes not substantially identical with the particular South Carolina statute involved.

Prudential v. *Benjamin* did not even deal with a retaliatory tax, although such a tax was one of three taxes considered by the Supreme Court of Kansas in *In Re Insurance Tax Cases,* 160 Kan. 311, 161 P. 2d 734 (1945), affirmed *per curiam* by this Court (*Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946)). The Kansas Court was unable to find on the record before it any evidence that foreign insurers were taxed more heavily than domestic insurers. This Court affirmed on that record, without undertaking either an examination of the discriminatory impact of the particular retaliatory tax involved, or the discriminations involved in a multi-state pattern of retaliatory taxes.

Apart from commerce clause considerations, it is clear that neither *Prudential* v. *Benjamin* nor any other decision of this Court has passed on the question whether Congress also sought by enacting the McCarran Act to remove equal protection clause restrictions on the power of the states to discriminate against foreign insurers. The McCarran Act is

directed solely to the commerce clause. There is no suggestion that it was directed to any of the restrictions imposed by the equal protection clause on state taxation of foreign insurers. This Court has held to the contrary (*State Board of Insurance* v. *Todd Shipyards,* 370 U.S. 451, 457 (1962)).

Foreign insurers which have established businesses in a state under indefinite licenses were held under the pre-McCarran Act decisions to be protected by the equal protection clause of the Fourteenth Amendment. The imposition by a state of more onerous tax burdens on such foreign insurers than on the state's domestic corporations for the privilege of conducting an insurance business was held to constitute a denial of equal protection of the laws (*Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926); *Southern Railway Co.* v. *Greene,* 216 U.S. 400, 418 (1910); accord: *WHYY, Inc.* v. *Borough of Glassboro,* 393 U.S. 117, 119 (1968)). Western and Southern having established its insurance business many years ago under an unequivocal license to do business in California as construed by the California courts could not have been subjected, under the pre-McCarran Act cases, to more onerous taxes than those imposed on California domestic insurance companies. The retaliatory tax here involved which would have been repugnant to the equal protection clause before the adoption of the McCarran Act remains repugnant to that clause after the adoption of the Act.

III. RETALIATORY TAXES DO NOT SECURE COMITY, UNIFORMITY OF TAXATION OF FOREIGN INSURERS NOR EVEN-HANDED TREATMENT OF FOREIGN INSURERS.

The Board and *amici* supporting the California retaliatory tax urge that retaliatory taxes are intended to secure comity, uniformity of taxation by the states of foreign insurers and even-handed treatment by the states of foreign insurers. More than a century's experience with retaliatory taxes dispels these contentions.

The concept of comity as it is generally understood plays no part in the retaliatory taxation of foreign insurance companies. It is suggested by *amicus* ACLI that comity "implies that the foreign state not merely end discrimination against the legislating state's corporations but accept the legislating state's own standards as controlling for that state's corporations" (ACLI brief, p. 22). This, however, distorts the principles of comity. Comity implies a respect by one state of the laws of another state and comprises an acknowledgment that separate governmental entities legislate based upon their unique needs and public policies. Comity is a willingness to grant a privilege out of deference and good will, not as a matter of right. *See e.g., Dow* v. *Lillie,* 26 N.D. 512, 144 N.W. 1082, 1088 (1914).

Retaliatory taxes do not evoke even the spirit of comity, for the principle which undergirds the retaliatory tax system is that one state may try to impose its insurance tax structure upon another state. Contrary to any sense of respect, such pressure is in disrespect of the laws of the other state which should be free to peg taxes on insurance companies on the basis of local revenue needs. If the legislature of the other state does not respond by reducing

its taxes on foreign insurance companies, a penalty is imposed by the taxing state not upon the other state but upon the insurers of such other state.

As presently constituted, retaliatory taxes permit revenue-rich states to dictate to revenue-poor states the level of taxation of foreign insurance companies to be imposed by the revenue-poor states. Revenue-poor states are thus urged to forego insurance tax revenues in order to protect their domestic insurers from retaliatory taxes. *See* Brief of the State of New York as *Amicus Curiae* (p. 2-3). Retaliatory taxes rest on the misguided assumption that states should not be permitted to generate insurance tax revenues in a manner most suitable to their individual revenue needs. Implicit in retaliatory taxes is that the taxing state knows better what the ceiling should be on the taxation of foreign insurance companies by other states.

If, as is suggested by ACLI in the brief, it is comity for one state to force its laws upon other states, then Oklahoma is the only state having a retaliatory tax to achieve comity, for all Oklahoma insurers are taxed at a 4% rate on business they do in the other 46 states having retaliatory taxes. Such a concept of comity is contrary to the assertion that retaliatory taxes result in uniformity of taxation of foreign insurance companies or that they generally tend to keep down state premiums tax rates on foreign insurance companies.

Nor have retaliatory taxes resulted in uniformity in the taxation of foreign insurance companies by the states. The ACLI brief, referring to Appendix B of the LICONY brief, suggests that most states tax the premiums of foreign insurance companies at 2% and that this bespeaks the efficacy of retaliatory taxes to achieve uniformity in the taxation of foreign insurance companies (ACLI brief, p. 27). The Board's brief is more precise, pointing with pride to

the fact that "twenty-six states share the same exact rate of 2%" (Board brief, p. 34). Similarly the Property Insurers' brief comments on uniformity by pointing out that "[t]hirty-six states and the District of Columbia impose gross premiums taxes of between 2 and 2.5 percent on out of state property and casualty insurers" and that "[a]pproximately half of the states have settled on 2 percent as the appropriate level of taxation" (Property Insurers' brief, p. 22).

These observations reflect the lack of uniformity in the 47 states having retaliatory taxes. Looking only at those 47 states, an examination of Appendix B of the LICONY brief reveals that 24 of the 47 states tax some or all of the premiums of foreign life insurance companies at rates different from 2%. Similarly, an examination of Appendix B of the Property Insurers' brief indicates that 24 of the 47 states tax the premiums of foreign property and casualty insurance companies at rates different from 2%. There are numerous other significant variations in the premium taxation of life insurance companies by the states and in the way retaliatory taxes are computed in the states having such taxes. *See* LICONY brief, p. 20-22. The lack of uniformity is patent. More than a century of experience with retaliatory taxes has not only failed to achieve nationwide uniformity, but has produced a chaotic patchwork of confused and often discriminatory tax laws applicable to insurance companies. There is little likelihood that further experience will improve matters to any degree.

Nor have retaliatory taxes resulted in the even-handed treatment of foreign insurance companies by the 47 states having retaliatory taxes. Looking only at Appendix B of the LICONY brief, is it even-handed for all Oklahoma life insurance companies to pay a 4% premimus tax on any business they do in the other 46 states having retalia-

tory taxes or for all Ohio life insurance companies to pay premiums taxes at a rate of at least 2.5% on any business they do in the other 46 states having retaliatory taxes, especially when insurers from low-tax (revenue-rich) states generally pay the prevailing foreign company rate of tax on any business they do in the other states having retaliatory taxes? If that is even-handedness, it is decidedly horizontal and works its greatest disfavor upon the insurance companies of the high-tax (revenue-poor) states. Even-handedness is better achieved on a vertical basis where all insurance companies of a given type (*e.g.*, all life insurance companies), or at least all foreign insurance companies of a given type, competing for business within a state are taxable at the same rate and, therefore, contend with the same relative tax burden.

It has been suggested that the fact that only 17 states levy higher premiums taxes on foreign insurance companies than are levied by California demonstrates the effect of California's retaliatory tax in establishing uniformity in the treatment of California insurers and, specifically, that "[t]hirty-two states afford California insurers the same or better treatment than that [2.35%] which California offers" (ACLI brief, at page 27). Retaliatory taxes cut two ways. The very fact that only 17 states (including the three states — Hawaii, New Mexico and North Carolina — having no general retaliatory tax) levy higher taxes on foreign life insurance companies than California levies also means that California life insurance companies are subject to retaliatory taxes in the 32 other states which levy lower taxes (without regard to retaliatory taxes) on foreign life insurance companies than California's 2.35% rate. Thus, retaliatory taxes result in the uniform taxation of California life insurance companies in 32 states, but to their competitive disadvantage in each and every case.

Retaliatory taxes evidence a high level policy which is inconsistent with our federal system.[2] States, especially revenue-poor states, should not be compelled to pit their tax rates against the tax rates of other states.

CONCLUSION

Both California tax provisions which Western and Southern is challenging should be declared unconstitutional because they are fundamentally wrong. The denial of the home office deduction to some, but not all, foreign insurers denies due process and equal protection. The retaliatory tax penalizes some to the advantage of others; and, make no mistake, those who have the advantage are greater in number and are its proponents; those such as Western and Southern who bear the penalty are in the minority.

The judgment of the Court of Appeal of the State of California, Second Appellate District, should be reversed, and the judgment of the Superior Court of California for the County of Los Angeles should be reinstated.

Respectfully submitted,

Alan R. Vogeler

Attorney for the Appellant,
The Western and Southern
Life Insurance Company

---

[2] The Property Insurers' brief (p. 23-26) cites examples of federal tax provisions which empower the President to increase taxes on citizens and corporations of foreign countries depending upon taxes in those countries. It asks ". . . why should the same purpose and the same means be denied to the 47 states having retaliatory laws?" The answer is that the states of the Union are not foreign governments and that the sense of the commerce and equal protection clauses of the Constitution is that states are not to treat each other as foreign countries nor to deny equal protection to corporations from other states doing business within their borders.

ADDENDUM

California Constitution, Article XIII, § 14-4/5 (e) :

(e) Deductions.

(e) (1) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(2) In the event a portion of the real property described in paragraph (1) of this subdivision is occupied by a person or persons other than the insurer the deduction granted the insurer by said paragraph shall be limited to that percentage, not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real propery upon which construction of the home office or principal office of the domestic insurer commenced prior

to January 1, 1970. As used in this paragraph, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(3) The phrase "person or persons other than the insurer" as used in paragraph (2) of this subdivision shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities. The Legislature may define the terms used in this paragraph for the sole purpose of facilitating the operation of this paragraph.

California Constitution, Article XIII, § 14-4/5 (f):

(3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other

obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this paragraph (3) of subdivision (f).

The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.